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STUDY OF POSSIBLE EXTENSION OF US AID

TO ICELAND

27072

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SWNCC Special Ad Hoc Committee)

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I. ANALYSIS OF THE SITUATION

A. Basic Forces

Iceland, which achieved its complete independence only in 1944 following the dissolution of the Union with Denmark, possesses a democratic and republican regime generally oriented toward the US by political and cultural sympathies as well as by economic and strategic considerations. Accustomed to a centuries-long geographical and political isolation and to a comparatively low standard of living, the diminutive Icelandic Republic emerged from the war period a focal point of international interest in air strategy and enjoying a wave of unprecedented economic prosperity. The impact of the war and its aftermath have consequently created certain stresses and strains related chiefly to (1) the adjustment of Iceland's still prosperous though inflated economy to altered post-war world conditions; (2) foreign base issues arising out of the country's new strategic position; and (3) the emergence of an enlarged and strengthened Communist movement intent on exploiting present difficulties for its own ends and those of the USSR.

These problems do not pose an immediate threat to the maintenance of Iceland's democratic and republican institutions. Beneath the political fragmentation and excessive individualism which generally characterize Icelandic politics, there is a basic allegiance to the principles of democracy which are deeply rooted in the country's ancient past and which have been strengthened through the long struggle for freedom from Danish rule. The principal concern aroused by the existence of these problems is that, lacking proper solution, they may lead to a deterioration of the present

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political climate, which is favorable to the US.

1. Economic Situation. Iceland depends to an unusual degree upon imports for its requirements in food, raw materials, and manufactures. Its exports consist almost entirely of one commodity -- fish. As a result, Iceland's economy is extremely vulnerable to fluctuations in international trade.

During the war and for some time after, Iceland benefited greatly from the presence of Allied garrisons and from exports of fish and fish products at prices relatively higher than the prices of its imports. This enabled the country to build up considerable reserves of dollars and sterling, which it has been expending to raise its standard of living, and to import substantial quantities of capital equipment which were primarily used to modernize the fishing industry and agriculture.

Iceland is now facing adverse economic developments due primarily to the high labor and production costs of its fishing industry in the face of the imminent fall in the price of fish. This adverse trend is reflected in the increasing difficulties in disposing of fish at current prices as other producing countries have re-entered this field since the war. The near exhaustion of the foreign exchange reserves accumulated during the war will make it difficult to cushion the readjustment which will be necessary. The resumption of normal prewar markets in Southern Europe and Germany cannot at present make available to Iceland either convertible currency or sufficient quantities of required goods.

With a lowering of the prices of fish relative to the prices of goods Iceland has to import, the Icelandic standard of living will have to be re-

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duced from its high wartime level. Since the large imports of capital equipment during the last few years have increased the efficiency of the Icelandic fishing industry and agriculture, it seems probable that, although the fall in the standard of living may be great, it is likely to remain above prewar levels.

2. Foreign Bases. Because of their long isolation from the main channels of international political intercourse, their intense nationalism, developed during the period of Danish rule, and their consequent susceptibility to all implications of infringements on their freedom, Icelanders have reacted unfavorably to the new role that strategic air power is forcing on them. As a result, a strong but wholly unrealistic sentiment for a return to international political obscurity persists.

Many political leaders undoubtedly recognize the implications of the new strategic situation, but the present isolationist temper of the nation demands reiteration of the theme independence, freedom from foreign influence, and freedom from the hegemony of any Great Power. When the issue of permanent US bases was raised in the fall of 1945, this isolationist sentiment was exploited by the Icelandic Communists with the result that an agreement for permanent US base rights became impossible of attainment at the time. The Airport Agreement of October 7, 1946 with Iceland gives us the best solution currently obtainable, namely, the use for a minimum period of 6½ years of Keflavik Airport by aircraft operated by or on behalf of the US Government in connection with its obligations to maintain control agencies in Germany. Under the Agreement the "sovereign rights" and "ultimate authority" of

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Iceland to control and operate the Airport are recognized, though actual operation and the necessary development of the field are being carried out by the US in view of Iceland's limited resources and shortage of technical personnel. Although in the event of another world conflict informed Icelanders would welcome -- although reluctantly -- the return of US troops as the best guarantee of the country's political, economic, and military security, any concessions to US strategic requirements in time of peace will continue to be a source of agitation in Icelandic domestic politics.

3. The Communist Movement. One of the most significant and disturbing factors in the Icelandic political situation is the increase in strength and influence of the Communist Party. In the election of 1942, and again in 1946, the Communists secured 10 seats in Parliament and almost 20 percent of the popular vote, as compared with three seats and 8.5 percent of the popular vote in the last prewar elections of 1937. This growth of the Communist movement -- a curious phenomenon in a period of unprecedented economic prosperity -- can be explained largely by (1) the broad labor support accorded to the party's vigorous campaign for higher wages and better working conditions, and (2) popular responsiveness to the party's campaign against the presence of foreign troops, waged both during and after the war. Moreover, in a country accustomed to state trading, powerful cooperatives, etc., the declared economic objectives of the Communists seem much less radical than in countries where emphasis is placed on free enterprise. The foreign connections and inspiration of the Communist Party, on the other hand, apparently are not readily perceived or feared by large segments of the population.

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Currently the third largest party in Iceland, the Communists exert an influence in the country and in Parliament which is far out of proportion to their numerical strength. This disproportionate influence arises from (1) their domination of the Icelandic Federation of Trade-Unions, and especially of the powerful Reykjavik unskilled laborers' union, and (2) their success in exploiting divisions between and within the three non-Communist political parties -- the Conservatives, Progressives, and Social Democrats. These levers of Communist influence opened the way for the party's participation in the Thors government in 1944, from which position they sought unsuccessfully to prevent the acceptance of the Iceland Airport Agreement. As a result of their defeat on this issue, the Communists withdrew from their coalition with the Conservatives and Social Democrats, thereby precipitating the Government's fall. Current Communist tactics are directed to keeping alive the Iceland Airport issue with a view to preventing the renewal of the present agreement and to exploiting present economic issues in order to provoke the collapse of the present non-Communist Cabinet and thus pave the way for their own return to the Government.

There is little likelihood that the Communists will resort to revolutionary tactics to achieve power in Iceland. Although the country maintains no military establishment which could be used against an attempted Communist coup, the tradition and temperament of the people are opposed to violent action, and the Communists would find it difficult to proceed through non-parliamentary means. Barring drastic and long-range deterioration of the economic system, with disruptive political effects, the democratic and republican institutions of Iceland are secure.

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B. The Stefansson Government

The present non-Communist Government of Iceland, composed of Social Democrats, Progressives, and Conservatives, represents the most desirable combination of Icelandic political forces from the point of view of US interests. Formed in February 1947 under the leadership of Social Democratic leader Stefan Johann Stefansson, the Government is united only in its general opposition to the Communists and in its Westward orientation. Economically, it reflects rather widely opposed interests: the Progressives represent the farmers and the cooperative principle, the Conservatives, as businessmen, favor free enterprise; and the Social Democrats, representing the minority wing of the Icelandic labor movement, advocate, in the Scandinavian tradition, a diluted Marxist socialism. Because of the uncertain allegiance of the Progressives, stemming in part from internal dissension in that party, the position of the Stefansson government is somewhat unstable.

The continued existence of the present coalition depends primarily, however, on its ability to solve the present problem of inflation and the threatened contraction of foreign markets, and on its success in preventing the recurrence of violent agitation against the presence of US personnel at Keflavik Airport. The task of the Government is especially difficult because the solution of the economic problem must inevitably be sought in the reduction of currently inflated wages and income, thus lowering the living standards. The Government has already adopted measures for the restriction of other than basic imports and has greatly increased the taxes on them in order to protect its diminishing foreign exchange reserves and to reduce consumer purchasing power.

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It is expected that fairly extensive sales of the 1947 fish catch and fish products to the USSR on the basis of dollar payments to Iceland will ease the problem of markets and dollars somewhat during 1947. However, the Government's prospects of checking the inflationary trend may be jeopardized by Communist-inspired strikes for further wage increases based on the contention that taxation of imports has increased the cost of living to the worker. While there is a possibility that the Government may successfully withstand these Communist-inspired reactions to a program which must in the circumstances be deflationary, a sudden decline in Icelandic living standard would undoubtedly cause the present Government's collapse and the return of the Communists to the Cabinet.

C. Objectives and Methods of Other Great Powers

1. USSR. For geographical reasons the USSR's primary strategic objective in Iceland is to prevent the use of the island for the defense of the Western powers by fostering anti-Western sentiment among the Icelanders, and, conversely, building up Soviet influence through increased trade and cultural relations.

Until 1946, Soviet trade with Iceland was insignificant. However, as a result of a Soviet-Icelandic trade agreement concluded in May of that year, one month before the first postwar national elections, Soviet purchases of Icelandic fish during 1946 amounted to 25 percent of the total catch and exports of all kinds to the USSR equaled 19.8 percent of Iceland's total exports. Moreover, since Soviet deliveries of coal and wood fell far short of the amounts pledged, a balance of more than \$7 million was transferred to the Icelandic account in dollars, in keeping with the terms of the agreement. Soviet-Icelandic trade during 1947 may afford Iceland an even greater

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dollar balance than in 1946; it appears that this result will depend, however, on Iceland's ability to make agreed deliveries of herring oil to the USSR.

The chief instrument of Soviet propaganda in Iceland is, as elsewhere, the Communist Party; although the Soviet Legation in Reykjavik maintains a large staff, it has no information or cultural affairs offices. The Icelandic Communist Party sought to obstruct British occupation of the island in 1940 and has since directed its campaign against the acquisition of bases by the US. Current Communist tactics are aimed at hindering US activities in connection with the operation of the Keflavik airport, undermining Icelandic confidence in US pledges, and promoting closer USSR-Icelandic trade relations with a view to reducing -- for political reasons -- Iceland's economic dependence on the West.

2. Great Britain. British interests in Iceland are similar to those of the US. The present British Government wishes the maintenance of a free, democratic Iceland oriented toward the Western powers. The strategic importance of Iceland to British defense was indicated in 1940 when British forces occupied the island following the German invasion of Denmark. Since 1941, however, the British have recognized that the preservation of strategic defenses in Iceland is a concern primarily of the US.

Present close British relations with Iceland are based largely on trade, Great Britain being Iceland's chief source of supply and market for fish products. In 1946, Iceland sent 36 percent of its exports to the United Kingdom and secured there 37 percent of its imports. Strong cultural relations with Iceland are maintained through BBC broadcasts and through the visits of British lecturers to the University of Reykjavik and to other

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Icelandic schools. A British-Icelandic society is also very active in Reykjavik.

II. ANALYSIS OF THE ASSISTANCE ALREADY GIVEN

From the outset of World War II, the US Government recognized the vital importance of Iceland to the strategic defenses both of the UK and of the Western Hemisphere. Consequently, it was politically and economically desirable to preserve the island's economy from the collapse threatened by the cutting off of its chief markets and sources of supply in Europe. An Export-Import Bank Loan of \$1 million was therefore granted to Iceland in March 1940 for the purchase of agricultural and industrial supplies in the US. Only \$590,000 of this credit was actually used by Iceland and the loan was retired in June 1943. To give further assistance to Iceland's economy as well as to provide Great Britain with vitally important fish products to support its wartime economy, the US took over in October 1941 the purchase of Icelandic fish exports to the UK, paying for them in dollars which were charged to British account as defense aid under the Lend-Lease Act. This arrangement was gradually terminated after 1943, since which time the US has extended no assistance in any form to Iceland; and none is pending. Until April 1947, however, when the US garrisons were withdrawn from the island, Iceland earned extensive dollar balances through military expenditures. Iceland has also benefited through the purchase -- for \$5,476,467 in cash -- of surplus properties, including vehicles and army barracks, originally produced at a cost of \$13,818,466.

The dollars made available to Iceland by the Export-Import Bank loan and the British lend-lease arrangement enabled Iceland to recover rapidly from the disruption of its export and import trade in the early years of the

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war. The British lend-lease arrangement also contributed, along with earnings from US military expenditures in the country and the expansion of Iceland's exports to the US, to Iceland's accumulation of dollar assets, which totaled \$44 million at the end of 1944. Iceland has used a portion of its accumulation of dollars and sterling to finance its relatively extensive program for the modernization of fishing and agricultural equipment, plant expansion, and municipal improvements. The country's high war-time receipts of foreign exchange naturally led to expansion of Iceland's domestic banknote circulation -- to an abundance of ready money. The intensified competition for and scarcity of labor, and the rise in demand for consumer goods, are directly traceable to the increase in individual holdings of kronur and in turn constitute basic factors in the development of Iceland's present inflation problem.

III. US OBJECTIVES

A. General

The US desires to see Iceland maintain a stable government, Westward-oriented, cooperative in international matters, and existing with the support and consent of the people. The democratic tradition is old and strong in Iceland; the present non-Communist Government looks to the West and desires continued friendly relations with both the US and the UK. It particularly desires enlarged exports to the US, which has remained an important source of supply of industrial and agricultural goods. The stability of the present rather shaky coalition cabinet would be threatened by a serious economic crisis, but there is little danger at present that an extremist political group would attempt to seize power. The Communists are not strong enough to attempt a coup, nor would the temper of the people per-

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mit it; but this party might be able to return to the government in a coalition with one or two of the other parties and therein receive concessions to its point of view with eventual damage to our general objectives.

B. Specific

Under the terms of the Iceland Airport Agreement of October 7, 1946, the Icelandic Government may cancel the landing rights granted to the US after a period of six and one half years. ~~Because of the strategic importance of Iceland as a potential naval and air base the US considers Iceland to be vital to its security. ~~Because the Joint Chiefs of Staff consider Iceland to be vital to the security of the US.~~~~ Consequently, the specific objective of the US is to render permanent the present temporary arrangement, or an expanded one, but to deny the same to any unfriendly power. It is therefore desired to insure preservation of America's long-range strategic interests.

IV. CONSIDERATION OF ALTERNATIVE MEANS OF REACHING OBJECTIVES

A. Economic

The cessation of dollar earnings from the expenditure of US military garrisons in Iceland, together with the extensive Icelandic expenditures for capital equipment and consumers' goods from the US and UK, have nearly exhausted Iceland's foreign exchange reserves. The immediate concern of the US, therefore, is to prevent Iceland's already weakened foreign exchange and export marketing position from deteriorating to a point where it might impose a sudden, rather than gradual, reduction in the population's standard of living and, consequently, engender a serious economic crisis which would threaten political stability. There are several alternatives for making additional dollars available to Iceland:

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(1) An arrangement by which OMGUS would purchase Icelandic fish for consumption in the US occupation zone in Germany, with immediate payment, in whole or in part, in dollars. In addition to furnishing Iceland with dollar exchange, an agreement along these lines would enable Iceland to market certain types of fish, the outlet for which has contracted considerably since the war. Obstacles to such an arrangement, however, are (1) the high price of fish generally and of wet salt fish in particular, for which the Government in December 1946 guaranteed a minimum price of 17 cents per pound in the expectation of large sales to the USSR which did not materialize; (2) the low caloric content of fish; and (3) the reluctance of OMGUS to increase its occupation costs through agreements of this type. The Icelandic Government has recently declared itself willing to sell wet salted fish at 12.5 cents per pound, and to bear as a subsidy the difference between that price and the 17 cent minimum it must pay to producers.

(2) Purchase of Icelandic fish under US relief program. Greece, along with Italy, was an important prewar market for inexpensive Icelandic dry salt fish. Thus, purchase of Icelandic fish under the US relief program would assist in returning Icelandic trade to its prewar pattern as well as furnishing dollar exchange. Such an arrangement, however, would have to be studied in connection with the over-all needs of Greece; moreover, the objections that may exist to OMGUS purchase of Icelandic fish for Germany may be equally applicable to fish purchases for Greece.

(3) Encouragement of increased exports to the US. Icelandic exports of fish and fish products to the US (consisting mainly of cod liver oil and frozen cod fillets) amounted to \$5,902,500 or 13 percent of Iceland's total exports in 1946, as compared with \$3,900,000 or 10 percent in 1945. It is believed that Icelandic sales on the US market, particularly of

frozen fillets, could be considerably increased despite prevailing high prices of Icelandic fish and the operation of the US tariff. Such a development is highly desirable not only from the point of view of Iceland's present dollar position but also from the long-range view point of our political and economic relations with Iceland. This development is being retarded at present, however, either because of the lack of diligence on the part of the Icelandic trade representative in the US or because the Icelandic reliance on state trading is a hindrance to sales to US private importers.

(4) US credits. In the event that import restrictions imposed by the Icelandic Government and dollar receipts from favorable trade balances are insufficient to halt the excessive drain on Iceland's foreign exchange reserves, as seems likely, it may be desirable for the US to extend credits to Iceland for the purchase of the foodstuffs and merchandise required to prevent a sudden drop in Icelandic living standards.

(5) Credits from the World Bank and International Monetary Fund.

Since Icelandic needs will be for consumers' goods rather than productive capital equipment, it does not appear that Iceland would be eligible for a World Bank Loan. Iceland would be eligible for assistance from the International Monetary Fund; since the Icelandic contribution to the Fund is small, however, this assistance would be extremely limited.

(6) Free convertability of currency of Southern Europe. Free convertability of Southern European currencies would enable Iceland to obtain needed dollars from trade with that region instead of the unusable soft currencies now obtainable. All exports could then be used to pay for imports and thus help to cushion the inevitable decline in Icelandic employment.

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and the standard of living.

B. Political

Consistent with our announced principles for international conduct and our role in the UN, we can only achieve our general and specific objectives through economic assistance, friendly sentiment, and gentle persuasion. A stable economy, maintaining if not gradually expanding the standard of living, popular contact with Americans, American institutions, ideas, and cultural development, and a genuine interest in Iceland and Icelandic problems will tend to create a state of popular receptivity to American desires.

The United States presently has no information or cultural program in Iceland, the wartime USIS program having been discontinued. It ^{appears} ~~is~~ ^{should be pursued to} ~~too~~ good that a modest but minimum program ~~should~~ include one full-time cultural attaché, reconstitution and enlargement of the old USIS library, improved news service to the Icelandic newspapers, and visits by American lecturers who are recognized authorities in their fields. The same opportunity could profitably be extended to competent Icelandic scholars to lecture in American universities. It is particularly important to cultivate the good will and understanding of the Icelandic University group because of the persuasive role that its members play in the thinking of their countrymen. The University is a focal point of intense nationalism, of Communist sentiment among certain intellectuals, and thus frequently a center of anti-American sentiment.

The information program envisaged would have the following objectives:

(1) To explain the aims and methods of the US in its program to speed reconstruction and to assure the return of political stability in Europe; because the Icelandic character includes a strong dose of cynicism as well as intense nationalism, the people are generally responsive only to an

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intelligent presentation of facts.

(2) To counteract both Icelandic Communist and Soviet propaganda through the dissemination of factual knowledge about the United States. In view of American long-term strategic interest in Iceland and the continued use of Keflavik Airport, it is particularly important to stress respect for Icelandic independence and freedom.

(3) To emphasize America's continued interest in and support of international cooperation, including respect for the rights of small nations.

(4) To improve the flow of daily information about the United States into Icelandic commercial news channels, promote the exchange of artistic, professional, and scientific men and information, and provide through a conveniently located library, directed by an American-born Icelandic-speaking librarian, a center for basic reference works, newspapers, and current periodicals.

C. International Organizations

Under present world conditions, the United Nations should not be regarded as a fully alternative means for the achievement of United States' specific objectives in Iceland. Even if the prestige and authority of UN in world affairs become firmly established, it is believed that the Iceland Government would be extremely reluctant to make peace-time bases available to the UN for Security Council garrisoning with troops composed of American contingents. Therefore this remains an improbable alternative to permanent bases on the island.

United States' influence in Iceland may also be promoted through cooperation with the Icelandic delegation in United Nations. American delegates to UN can assist the Icelandic delegation to secure committee appointments, encourage it to give full expression to Iceland's views as a repre-

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sentative of the small nations, and acquaint it through personal contact with the reasons for the American point of view on various international questions.

Iceland is a member of the United Nations and of all the specialized agencies, except UNESCO and WHO. Because of the importance of maintaining cultural ties with the rest of the world, Icelandic membership in UNESCO might be encouraged.

The achievement of United States' general objectives as regards Iceland remains closely connected to the degree of prosperity on the European Continent, the logical outlet for Icelandic fish. Iceland will benefit economically and thereby politically through whatever arrangements ITO and other international organizations, such as FAO, are able to make to hasten the return of prosperity and increased international trade to Europe.

The detailed ways in which the economic machinery of the United Nations, as well as that of the specialized agencies, might be utilized in connection with a possible program of aid to Iceland have been set forth in Addendum of June 10 to SWNCC 360.

V. MAGNITUDE, NATURE, AND TIMING OF THE MEASURES REQUIRED WITHIN
THE NEXT THREE TO FIVE YEARS TO REACH THESE OBJECTIVES

Iceland will probably need help to cushion the shock of the forthcoming reduction in its standard of living, which currently is considerably above prewar levels. This high standard of living is reflected in the fact that taxable income, expressed in US currency, amounted to \$17.6 million 1938, and stood at the equivalent of \$111 million at the end of 1945. In terms of 1938 dollar value, the 1945 taxable income was approximately \$37 million, or more than twice that of 1938.

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The foreign exchange revenues received from the American and British garrisons in Iceland during the war, which helped to support the high standard of living, are no longer available. In fact, Iceland's foreign exchange reserves accumulated during the war are rapidly approaching depletion. Dollar reserves which amounted to \$22 million in January 1946 had declined to \$13 million by January 1947; in the same period sterling reserves fell to 14,200,000 (approximately \$17 million).

The decline in the price of certain fish types and products now setting in is turning the terms of trade against Iceland, so that for the same quantity of exports it should expect to receive a lower quantity of imports compared to the immediate past. Although 1946 exports were the highest on record (\$44,840,000), due largely to profitable sales of frozen fish and herring oil to the USSR, Iceland had an unfavorable trade balance of \$23,360,000. A large part of this unfavorable balance was incurred by the purchase of capital equipment for the modernization of fishing and agricultural apparatus; further deliveries on the capital equipment program during 1947 may be expected to produce another unfavorable trade balance for this year. It is doubtful, however, whether new investment alone can increase productivity and lower production costs sufficiently to prevent a drastic decline in Iceland's living standards in the direction of prewar levels.

The Icelandic Government could conceivably introduce by successive stages financial reforms of its own designed to reduce both domestic costs and export prices, and thus improve the nation's export marketing position. Strict enforcement of income and excess profits tax laws (enforcement is now very lax) would yield an increase in Treasury revenue. Devaluation of Iceland's currency, with prior education of the public to the necessity for this action, would also help to bring export prices for

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Icelandic fish into line with world markets. With lower labor costs it would become economic for Iceland to resume large-scale preparation of dried salted fish and thus to re-enter markets in Spain, Portugal, Brazil and Cuba.

A balanced program of economic reform involving measures of the type described in the preceding paragraph would probably have to extend over a period of years. The US could assist Iceland in the orderly achievement of such reforms either through making US financial experts available to the Government of Iceland, or through support of an advisory mission under the auspices of the International Monetary Fund.

In any event, short-term credits from the US may be necessary.

To prevent a sudden collapse of the living standard and consequent political unrest which might adversely affect US objectives in Iceland, it may be necessary for the US to extend aid to Iceland over the next two or three years. It is likely that \$20 million ^(over a period of two or three years) in the form of credits (or in the form of supporting high prices for the Icelandic fish catch) would be adequate to compensate for export income losses and to cushion the shock of a suddenly lowered standard of living. Icelandic dollar assets may be used up by the beginning of 1948. To be effective politically, the assistance should be extended before the complete exhaustion of the dollar balance outstanding off Icelandic purchases from the US of foodstuffs and industrial goods necessary to prevent widespread economic distress.

VI. PROBABLE AVAILABILITY OF ECONOMIC AID FROM EXISTING SOURCES UNDER PRESENT POLICIES

The Icelandic Government has neither requested nor indicated a desire for financial assistance from any source. It is possible that finan-

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cial assistance, if requested, might be accorded by the Export-Import Bank, but Iceland's priority might not be high in view of the more critical needs of other nations. Moreover, the present policy of the Export-Import Bank is to grant credit only for development purposes. There is little prospect of Iceland's securing much assistance ^(in the form of loans) from the UK or other European countries. While the UK might extend credits for the purchase of industrial goods such as textiles, the British probably could not supply foodstuffs, which form an important part of Iceland's imports. Iceland is eligible to receive \$250,000 annually from the International Monetary Fund; these sums, however, would be inadequate for Iceland's needs.

VII. ADDITIONAL MEASURES REQUIRED FROM THE UNITED STATES

There are no measures other than those cited in IV and V that would constitute a practical contribution to the attainment of US objectives as regards Iceland.

VIII. NATURE OF ARRANGEMENTS WITH THE ICELANDIC GOVERNMENT TO SECURE THE ACCOMPLISHMENT OF OUR OBJECTIVES IN TAKING SUCH MEASURES

Economic assistance accorded to Iceland by the US would require no supervision. There is little likelihood that credits would be utilized to purchase any but the most necessary requirements or that such aid would be used to maintain an undemocratic group in power. Moreover, any attempt to secure guarantees other than those which ordinarily are included in credit agreements would be regarded by Icelanders as an infringement of their independence and consequently might have unfavorable political repercussions.

IX. EFFECTS UPON ICELAND AND UPON US FOREIGN POLICY OF US REFUSAL TO GRANT AID OR FAILURE OF PROGRAM UNDERTAKEN

In the event that the US should refuse assistance requested by the

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Icelandic Government, or that the latter's measures for forestalling a sudden deterioration in the country's economic situation should fail, Iceland would experience a period of temporary economic dislocation and distress, the duration of which would depend generally on the rapidity with which the European economy recovers. Since Iceland depends to a considerable extent on imports for its food requirements, it is possible that in view of current world food shortages living standards during this temporary period might fall somewhat below their prewar levels.

The political effects of such a sudden deterioration in Iceland's economic position would be extremely harmful to US objectives. The sympathy and good will toward the US of a large section of the population might well be forfeited. The chief beneficiary would be the Icelandic Communist Party, which would gain added strength in the country as a whole and would exert a considerably greater influence in the Government, to which it would undoubtedly return. In view of such developments, the prospects of securing a renewal of the present Iceland Airport Agreement would certainly be dimmed.

X. POSSIBLE EMERGENCY SITUATIONS WHICH SHOULD BE ANTICIPATED
AND RECOMMENDED COURSE OF ACTION FOR THE UNITED STATES

The only foreseeable emergency situation which might arise as regards Iceland is a premature deterioration of its economy precipitated either (1) by the failure or non-implementation of trade pacts negotiated with the USSR and the UK, or (2) by strikes in the herring fisheries, which provide the backbone of the Icelandic export trade. In such an eventuality, the US should seriously consider extending immediate assistance to Iceland. In the event the economic distress were precipitated by strikes, extreme

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care should be taken that the financial assistance accorded by the US
not give the impression of interference in the internal affairs of the
country.

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XI. SUMMARY

I. ANALYSIS OF THE SITUATION

A. Basic Forces

Iceland emerged from the war unprecedentedly prosperous and a focal point of international interest in air strategy. The war and its aftermath created three basic stresses: (1) an inflated economy requiring adjustment to altered postwar conditions, (2) the issue of foreign bases, and (3) the obstructionism of a strong Communist movement. Icelandic allegiance to democracy continues strong and, although the people are isolationist, the political orientation remains generally pro-Western.

1. Economic Situation. Iceland lives by the export of fish while importing food, raw materials, and manufactures. War profits from fish sales and garrison expenditures brought prosperity and built up reserves of dollars and sterling that are presently being expended for modernization of the fishing industry and of agriculture.

Iceland's basic economic problem arises out of inflated production costs in the face of falling world prices for fish and renewed competition from other producers. Furthermore, the normal prewar markets in southern Europe and Germany are unable to pay for Icelandic fish either with hard money or with the goods Iceland needs. As artificial wartime markets have largely disappeared, a reduction in the standard of living must follow.

2. Foreign Bases. History has intensified the sentiments of isolation and nationalism in Iceland. Therefore the people have reacted unfavorably to their island's new role as a target of strategic competition. Communist exploitation of this sentiment was largely responsible for preventing the US from obtaining long-term base rights in the fall of 1945. A short term agreement signed October 7, 1946 gave the US landing rights at Keflavik Airport for a minimum period of $6\frac{1}{2}$ years. In protest the

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Communists resigned from the Cabinet and precipitated the fall of the Government. A new government, from which the Communists are excluded, has since been formed.

3. The Communist Movement. Communist strength has remained roughly unchanged since 1942 at 20 percent of the popular vote and 10 seats in a Parliament of 52 members. Support of workers' wage demands and exploitation of the foreign troops issue explain Communist wartime growth. The party's influence is disproportionate to its voting strength because of its dominant position in the labor movement and its ability to exploit other parties' differences. A member of the coalition Government from 1944 to 1946, the Communist Party is now attempting to win readmission to the Government by both parliamentary means and the use of the strike weapon.

B. The Stefansson Government

The present Government, headed by a Social Democrat and supported by the Conservative (business interests) and Progressives (farmers and cooperatives), is a desirable combination for US interests. Its future depends primarily upon solution of the problems caused by inflation and contracting foreign markets. The Government is faced by the fact that the Icelandic standard of living is bound to fall. A sudden economic depression or successful Communist-led strikes for general wage increases would probably topple the Government.

C. Objectives and Methods of Other Great Powers

1. USSR. The Soviet Union's strategic objectives in Iceland are:
 - (1) to deny use of the island to the Western Powers as a defense base, and
 - (2) to promote closer Soviet-Iceland trade and cultural relations. Practically without commercial interest in Iceland before the war, Russia took

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19.8 percent of the island's total exports in 1946 and desires expanded trade for 1947. The Communist Party remains Russia's main propaganda instrument in Iceland.

2. Great Britain. British interests in Iceland are similar to those of the US. Close commercial relations prevail with Great Britain, which receives and provides slightly over one-third of Iceland's exports and imports respectively.

II. ANALYSIS OF THE ASSISTANCE ALREADY GIVEN

Out of regard to our own strategic interests the US Government in 1940 aided the war-beleaguered Icelandic economy with a \$1 million Export-Import Bank Loan. In October 1941, under a lend-lease arrangement, the US undertook to pay in dollars for Icelandic fish exports to the UK. Other than the sale for cash of surplus property and the expenditures of the American garrison, the US has provided no assistance since the end of 1943.

The wartime accumulation of foreign exchange made possible the purchase of capital equipment, but also contributed to Iceland's inflation by providing the basis for expanded bank note circulation.

III. U.S. OBJECTIVES

Generally, the US desires to see Iceland maintain a stable, Westward-oriented government, cooperative in international matters, and existing with the support and consent of the people. The present friendly Government rests upon an insecure political foundation that can be destroyed by a sudden economic crisis.

because of Iceland's importance as a potential naval and air base
Specifically, the US desires to make permanent and exclusive its present, or expanded, base rights.

IV. CONSIDERATION OF ALTERNATIVE MEANS OF REACHING OBJECTIVES

A. Economic

Iceland's foreign exchange resources are nearing exhaustion. The US

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problem, therefore, is to prevent economic deterioration to the point where a sudden rather than a gradual reduction in the standard of living would cause a political crisis. The following alternative means exist for making dollars available to Iceland: (1) Purchase by OMGUS of Icelandic fish for the German civilian population; (2) purchase of Icelandic fish under US relief programs; (3) encouragement of increased exports to the US; (4) US credits; (5) credits from the World Bank and International Monetary Fund; or (6) establishment of free convertibility of the currencies of southern Europe.

B. Political

Besides measures of economic assistance, the US must rely on gentle persuasion, exhibition of official sympathy for Iceland's problems, and popular contact between Icelanders and Americans in order to create receptivity to American desires.

The United States presently has no information or cultural program in Iceland. A modest minimum program should ^{be pursued to} include one cultural attaché, a library, improved news services to the Icelandic newspapers, and exchange of American and Icelandic scholars. The Icelandic university group is of particular importance to the US because of the local prestige of its members and their current, frequently anti-American slant of the radical element among them. An information program should be designed to explain America and American aims while countering Soviet propaganda.

C. International Organizations

The UN cannot be a fully alternative means for the realization of our specific objectives in Iceland. The Icelandic Government would probably object to the presence on its territory of Security Council troops of whatever nationality.

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The US delegation to the UN can promote US general aims by cooperation with and assistance to the Icelandic delegation. Iceland's membership in UNESCO should also be encouraged.

Any arrangements ITO and other international organizations can make for the return of prosperity and stability to Europe will benefit Iceland both economically and politically and thereby promote US general objectives.

V. MAGNITUDE, NATURE, AND TIMING OF THE MEASURES REQUIRED WITHIN THE NEXT THREE TO FIVE YEARS TO REACH THESE OBJECTIVES

Iceland is not in a position to maintain its present standard of living, now considerably above that of 1933. Although 1946 was a record export year, Iceland's dollar reserves alone fell from \$22 million to \$13 million during the year. The decline in the price of fish and additional payments for new capital equipment in 1947 will again mean an unfavorable balance of trade and continued depletion of Iceland's foreign exchange reserves. Iceland can therefore import fewer consumption goods and its standard of living must decline.

More effective tax collection plus depreciation of the currency would help reduce costs and thereby improve Iceland's world competitive position. US financial experts could assist in carrying out economic reforms, but these would have to be undertaken in successive stages extending over a period of years.

To be effective, US aid should precede an anticipated serious economic crisis. To cushion the shock of a suddenly lowered standard of living a credit of \$20 million, (over a period of two or three years) or the equivalent in the form of supporting high prices for Icelandic fish exports, is recommended.

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VI. PROBABLE AVAILABILITY OF ECONOMIC AID FROM EXISTING SOURCES UNDER PRESENT POLICIES

Iceland has little opportunity to secure loans from other governments or international agencies, but neither has it indicated a need for such aid.

VII. ADDITIONAL MEASURES REQUIRED FROM THE UNITED STATES

None other than those previously cited.

VIII. NATURE OF ARRANGEMENTS WITH THE ICELANDIC GOVERNMENT TO SECURE ACCOMPLISHMENT OF OUR OBJECTIVES IN TAKING SUCH MEASURES

Supervision of any economic assistance granted to Iceland is believed to be unnecessary to insure sound use of the funds, and politically inadvisable.

IX. EFFECTS UPON ICELAND AND UPON U.S. FOREIGN POLICY OF U.S. REFUSAL TO GRANT AID OR FAILURE OF PROGRAM UNDERTAKEN

A period of temporary economic dislocation and distress will result if the Icelandic Government's plans for preventing sudden economic deterioration fail, or if in such case the US should refuse to grant assistance. The results would be extremely harmful to US general and specific objectives and beneficial only to the Communist Party.

X. POSSIBLE EMERGENCY SITUATIONS WHICH SHOULD BE ANTICIPATED AND RECOMMENDED COURSE OF ACTION FOR THE UNITED STATES

There are only two foreseeable emergencies: (1) failure of the pending trade pacts with the USSR or the UK; (2) a strike in the vital and extremely valuable herring fisheries. Should either develop the US should seriously consider granting immediate assistance.

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